

What's Next for Seagram and Du Pont
J. B. Fuqua's Long-Running Soap Opera
Will Reaganomics Unravel?

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November 16, 1981

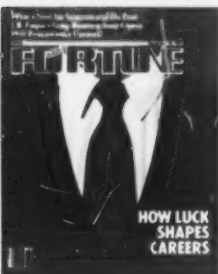
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Marvin Mattelson painted the horseshoe-sprinkled executive tie on the cover. An article on the role of luck in shaping careers begins on page 60.



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92 St. Louis



111 Strategy

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POLICY

Reaganizing the Third World

The new U.S. aid strategy is the only one that can work.

by ROBERT LUBAR

The informal proceedings of that extraordinary summit meeting at Cancún were off the record, but they may have borne some resemblance to those sessions in the Oval Office when Ronald Reagan was using his fabled charm to line up congressional votes for his budget and tax cuts. At Cancún the President was pleading the virtues of the international version of Reaganomics, a new U.S. policy for dealing with the poverty and backwardness that afflict the majority of mankind.

As it was unveiled in Administration statements leading up to the summit, global Reaganomics carries a stern message for the poor nations. First, they must rely on individual initiative, private enterprise, and trade to power their economic growth and development; aid from the rich can play only a subordinate, catalytic role. Second, the developing nations must shoulder a good deal of responsibility for their poverty, insofar as their economic policies frustrate the functioning of the

Research associate: Louis S. Richman

market and discourage the emergence of a vigorous private sector. Finally, further aid will be conditioned upon their willingness to change those policies. In the President's words, "Unless a nation puts its economic and financial house in order, no amount of aid will produce progress."

Taking on the establishment

At first hearing, the message got a cool reception, and not just in Third World countries, which are accustomed to lecture others, not to being lectured at themselves. In Europe and the U.S., Reagan was pictured as Scrooge preaching platitudes about self-reliance. The President will have to counter the impression that his policy is just an elaborate cover-up for slashing the U.S. foreign-aid budget. To convince skeptics, he must follow up with words and actions that demonstrate how the policy will work. This job of education and persuasion could prove far tougher than the one Reagan performed in getting his domestic program across, for it represents an even bolder challenge to conventional wisdom.

continued



A World Bank affiliate that acts like a venture capitalist, the International Finance Corporation put \$9.3 million of seed money into this \$300-million fertilizer plant in Aqaba, Jordan, which was built by a multinational consortium of investors. The plant is expected to help the Jordanian economy sprout \$200 million in export revenues and 600 new jobs when it goes into full production next year.

Where the market is given a chance to work, the development process has almost invariably taken off at high speed.

World poverty and how to deal with it are not the stuff of ordinary politics. The public is bored by it, and Congress has to be hounded into making decisions about it. That leaves the field of discussion to specialists and aficionados: academics, veterans of the foreign-aid bureaucracy, editorial writers, internationally minded corporate executives—the kind of people you would expect to meet at the World Affairs Council of Philadelphia, where the President, not coincidentally, chose to air his new policy first.

The prevailing view of this “establishment” is that a widening gap between the rich and poor nations threatens to plunge the world economy into crisis. Therefore, the rich nations have a material self-interest as well as a humanitarian obligation to correct the maldistribution of wealth by greatly increasing aid to the poor.

And that may be putting it mildly. The 1980 report of the Brandt Commission may fairly be said to reflect the establishment consensus (the U.S. members were Katharine Graham, chairman of the Washington Post Co., and Peter Peterson, head of Lehman Brothers). It called for “a large-scale transfer of resources to the developing countries” and “a start on some major reforms in the international economic system.” It contemplated supranational authorities with power to regulate world commerce and industry, and even to levy taxes. From there it isn’t a long jump to the New International Economic Order for which the Third World majority at the United Nations has been agitating since the early 1970s.

The Brandt report might well have set the terms of discussion at Cancún had it not been for the new U.S. policy, which puts things in an entirely different perspective. It sees not a monolithic bloc of humanity condemned to poverty and backwardness by an iniquitous system, but 100-odd nations at different levels of development, each advancing at its own pace. Some have climbed to “newly industrialized” status; some have reached the middle-income class; a number lag behind, their primitive economies able to

support a woefully meager standard of living. But all are “developing,” which is a dynamic concept; it implies change that can be measured only crudely by such statistics as growth in per capita GNP.

The development process is complex and unpredictable. Its ingredients are familiar—capital, education, technical and managerial skills, favorable culture, availability of natural resources—but their permutations and combinations are always different. Why, for example, did Spanish South America, founded on immense gold treasure, lag behind British North America, which developed out of an inhospitable wilderness? The artificial infusion of any single ingredient cannot guarantee an accelerated rate of development. In the past decade, the Arab states along the Persian Gulf were the beneficiaries of one of the biggest redistributions of wealth in history. They are high in per capita GNP, but they still rank low in development, and it remains to be seen whether they can transform their newfound riches into true progress for their people.

As the experience of Iran demonstrates, governments risk disaster when they intervene in the development process. By trying to force the pace, the Shah’s regime strained the bonds of a traditional society, uprooted large sections of the population, and led to the destruction of stability and order. In other instances, overeager leaps into industrialism have resulted in a monstrous misuse of resources, leaving landscapes strewn with abandoned steel mills, idle factories, empty luxury hotels—gloomy monuments to bad judgment and overweening ambition.

Where freedom rings

On the other hand, where the market is given a chance to work its magic, the development process has almost invariably taken off at high speed. Consider the amazing performance of Hong Kong and Singapore, both of which suffer from overpopulation, overcrowding, and lack of natural resources. They owe their success to their enterprising people and to governments that, instead of trying to plan

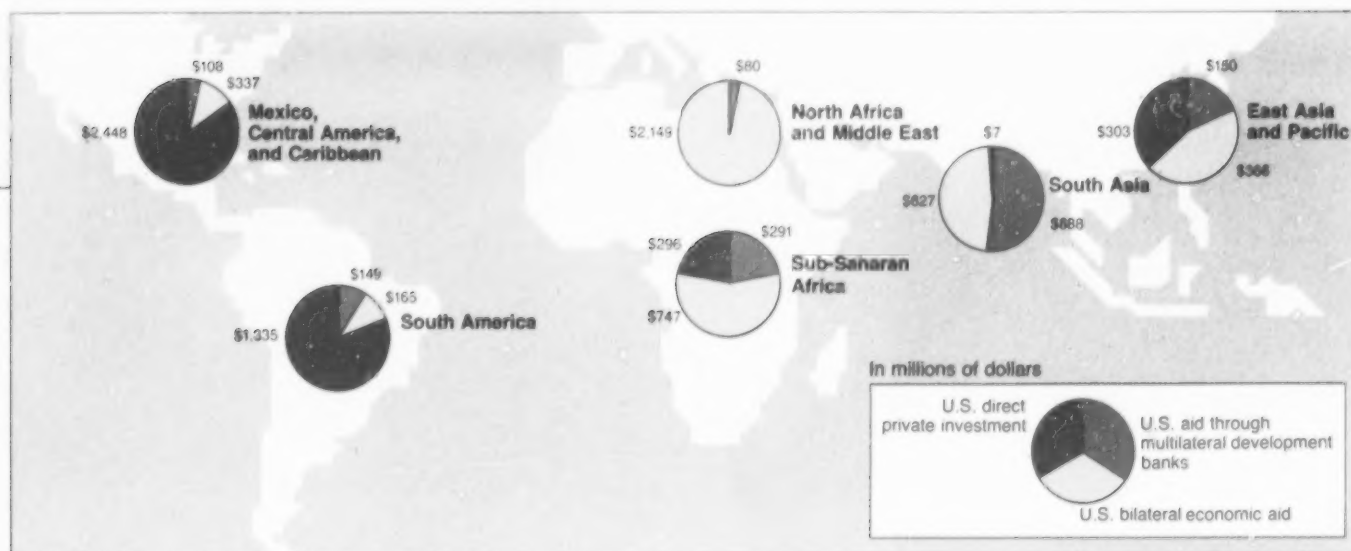
growth themselves, provided the freedom and incentives for individuals to save and invest and apply their talents as traders and manufacturers. President Reagan surely had Hong Kong and Singapore in mind when he pointed out in a recent speech that “the developing countries now growing the fastest in Asia, Africa, and Latin America are the very ones providing more economic freedom for their people—freedom to choose, to own property, to work at a job of their own choice, and to invest in a dream of the future.” The private-enterprise approach to development is not just ideological fetishism. It is the only approach that has worked.

Nations on welfare

Yet the notion persists that the Third World’s salvation rests on ever larger handouts from the rich nations. Like domestic welfare programs, aid has temporarily relieved distress and suffering, but can anyone name a country whose development was significantly accelerated by it? In fact, more often than not, aid has had adverse effects. It has fostered the illusion that the government *is* the economy and the source of everyone’s livelihood; that stifles individual initiative and encourages centralized development planning, whose unresponsiveness to market feedback results in waste. In some cases, aid creates the international equivalent of welfare dependency. Nations get to rely on it to balance their budgets and put off necessary corrective measures, which usually involve the painful reduction of swollen bureaucracies.

These considerations—not just penury—have led the Administration to assign aid a much more constricted role in development strategy. The policy calls for countries well up on the development ladder to be weaned from aid, on the supposition that if an aid project promises to earn an economic return, it can and should be financed by private lenders and investors; if it doesn’t have that potential, it ought to be scrapped. Countries at the bottom of the ladder, on the other hand, have economies so primitive that there’s no base on which

continued



The Third World Is a Mixed Bag

Although the developing "South" is described as if it were a monolith, it is neither monolithic nor entirely south of the equator. The World Bank divides developing economies into the six categories shown above. Per capita GNP is only one yardstick; crucial, too, are structural differences—for instance, the degree of industrial or agricultural production and whether a country is an oil exporter or importer. According to the most recent World Bank data, the "middle income" countries range from agricultural Kenya, with per capita GNP of

\$380, to semi-industrial Spain, whose per capita GNP came to \$4,380. Both Indonesia and Bhutan are classified as "low income" countries, but Indonesia, an oil exporter, had a per capita GNP of \$370; Bhutan, one of the world's "least developed" countries, barely subsisted on a GNP of \$80 per capita. Relative wealth is no guarantee of development. Libya, a capital-surplus oil exporter, grew less than 2% per year through the 1970s. Resource-poor South Korea, a middle-income semi-industrial economy, grew better than 10% annually.

development can take place. They need help in building roads and bridges and seaports, in improving health care, sanitation, and schools, in controlling their population growth, and in modernizing their agriculture. Investment in these areas could eventually yield a sizable economic return, but the payoff is too remote to attract private capital. Official aid is the only available recourse.

The Administration proposes to attach an important condition to that aid: recipient countries must discard policies that obstruct or distort the working of the free market—for example, subsidies, price controls, and manipulation of exchange rates. The immediate point is that the persistence of such policies impedes the effectiveness of aid, but the Reaganites see a chance to drive home the larger moral that the poor nations bear the responsibility for creating an economic environment that is conducive to growth. "We believe," explains Undersecretary of the Treasury Beryl Sprinkel, "that eliminating market obstacles will encourage internal capital for-

mation and capital inflows from abroad."

The new condition will bite particularly hard in agriculture, which is getting the largest share of development aid. In his provocative book, *The Evolution of the International Economic Order*, Princeton economist (and Nobel Prize winner) W. Arthur Lewis says the most important step in development is "to transform the food sector, create an agricultural surplus to feed the urban population, and thereby create the domestic basis for industry and modern services. If we can make this change, we shall automatically have a new economic order."

The politics of food

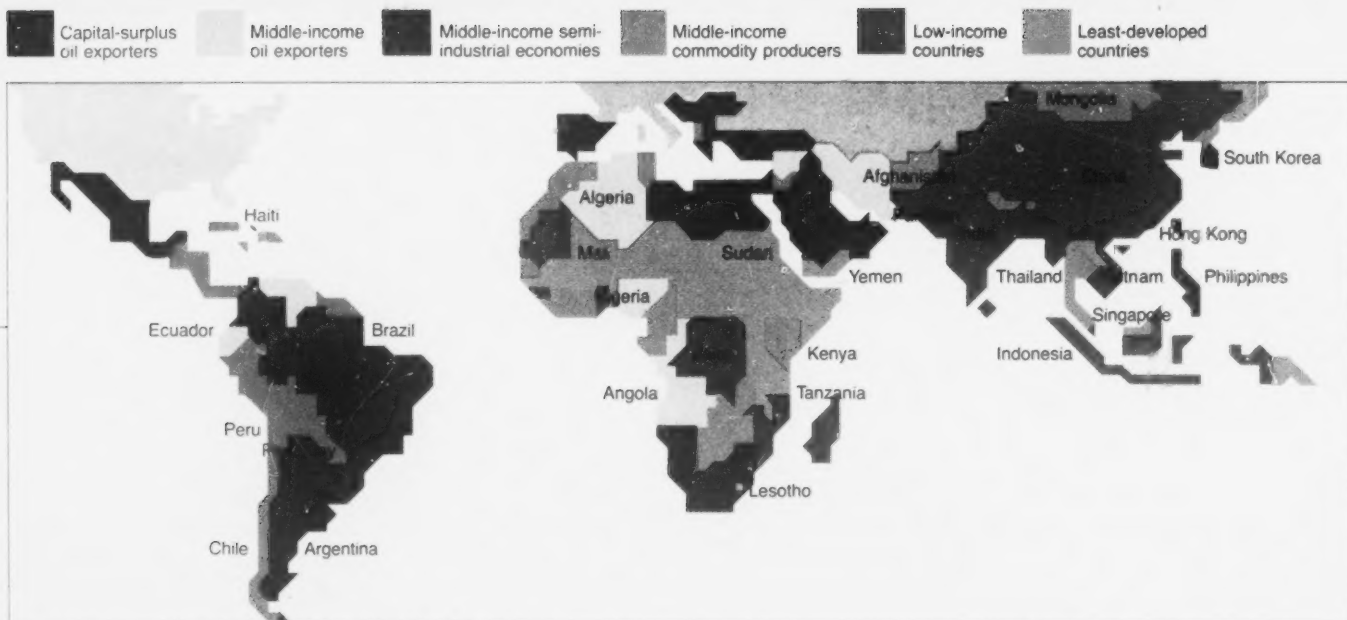
Unfortunately, many of the poorer countries have moved in the opposite direction. Indonesia, once nearly self-sufficient in rice, is now one of the world's leading importers of it, and Zaire, which used to export food, now uses a quarter of its export earnings to pay for imported food. The main cause of this deterioration was that struggling, insecure governments

kept food prices artificially low for the benefit of the urban population, which provided most of their political support. The low prices had the predictable effect of bringing down farm output. Now governments will get U.S. help for their agriculture—irrigation systems, fertilizer, technical advice—only on condition that they keep their hands off prices. (In this respect, it must be conceded, Congress is not setting a very good example in the U.S.)

Prodding the Bank

The U.S. can impose whatever terms it wants on bilateral aid—direct loans or grants to another government—but the Administration also wants the rules applied to the multilateral aid provided by the World Bank, the International Monetary Fund, and the three regional development banks. Its hard-sell diplomacy, conducted in public, blew up a flap just before the joint annual meeting of the Bank and Fund this fall. A series of apparently orchestrated press briefings and interviews, given by high Treasury officials, created

continued



Who Gets How Much of What Kind of Money

The "magic of the marketplace" casts its spell differently throughout the Third World. In Latin America net direct investment by U.S. corporations vastly exceeded official U.S. development aid last year. In contrast, U.S. aid distributed through the multilateral development banks—the World Bank, the Asian Development Bank, and the African Development Bank and Fund—accounted for the lion's share of assis-

tance in sub-Saharan Africa and populous South Asia. The U.S. passed out large dollops of bilateral aid to the Mideast and North Africa mainly because the regions are strategically important rather than because they need development capital. In fact, the net U.S. investment flow to this area was negative because the oil-rich states invested over \$2.75 billion more in the U.S. than American investors sent the other way.

the impression that the Administration was hopping mad about the openhanded policies of both the Bank and the Fund and was going to use its influence to rein them in. Officials later maintained that the impression had been unintended and that the media had exaggerated the whole affair.

As it turned out, the heads of the two institutions didn't need to be forcibly converted. The Bank's new president, A. W. Clausen, former chairman of the Bank of America, reaffirmed his devotion to conservative banking and economic principles; no one could mistake him for his predecessor, Robert McNamara, who often seemed eager to assume command of a global war on poverty. As for the managing director of the Fund, Jacques de Larosière, he was already on record as demanding from his clients "not just sound fiscal and monetary policies, but also complementary measures to enlarge the economic capacity of a country, provide better incentives for production, remove bottlenecks, eliminate distortions in cost-price relationships and resource allocation." The words could have come straight out of the White House.

Nevertheless, one gets the impression that the Administration hasn't quite made

up its mind about the multilateral lending institutions. It's conceded that U.S. aid dollars are used more efficiently when they join other nations' contributions in common lending pools and that the professional caliber and expertise of the multilateral agencies' staff members are incomparable. But some Reaganites suspect that, however admirable they may be, those international civil servants harbor empire-building tendencies that accord with some Third World ideas.

A global pork barrel?

Others—including many Congressmen—feel the U.S. should keep control of its aid dollars so it can be sure they go to friends, not enemies. They think foreign aid should primarily serve our strategic and national-security objectives. In fact, a substantial part of our \$6.5-billion budget for economic aid is being used to reward nations that have been loyal to us or who are deemed particularly vulnerable to Communist aggression. This aid has nothing to do with development—no one talks about requiring El Salvador or Pakistan to adopt free-market policies as a condition for receiving help. By confusing two issues, the Administration risks damaging the credibility of its development policy.

Prejudices against multilateral aid often focus on the International Development Agency (IDA), the World Bank affiliate that lends long-term, charging no interest, to the poorest countries. Every few years, IDA passes its hat around to replenish its lending funds; the sixth replenishment (known as IDA-6) is now in suspense. The Carter Administration pledged the \$3.2-billion U.S. share and Reagan promised to honor the commitment, but Congress is likely to stretch out the payments. Since the other countries will scale down their contributions accordingly, the "soft-loan window" isn't going to do much business in the next year or two.

The graduating class

That will be just fine with the Reaganites, who would like to see IDA's lending restricted to the very neediest cases. At present, 53% of it goes to "blend countries" that also qualify for—and have been getting—hard loans from the World Bank proper. In the Administration's opinion, they should be "graduated" out of IDA. Further up on the development scale are a few countries that borrow from the World Bank though they're sound enough to get regular commercial loans; these countries are also candidates for graduation.

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The new development policy is going to need a lot of creative interaction between the public and private sectors.

One World Bank affiliate is enjoying new favor in Washington. That's the International Finance Corporation, which might be described as the Bank's venture-capital subsidiary. It not only lends but takes equity positions in fledgling enterprises in developing countries. Its partners are investors in the country itself and may include others drawn from outside. When the business gets on its feet, IFC typically sells its equity interest and uses the proceeds to make new commitments.

Some of the ventures IFC helps finance are brought to it ready-made, but it often puts together projects, furnishes financial advice, seeks out managers and technical people, and does market surveys. In the 25 years since it was established, IFC has committed \$4 billion to some 600 ventures, representing a total investment of \$18.5 billion.

Lessons in capitalism

In recent years, IFC has broadened its franchise to include helping countries to form capital markets to mobilize and allocate the savings of their own citizens and to attract investment from abroad. Its capital-markets department acts as teacher and adviser on matters ranging from rudimentary accounting to the organization of banking systems and securities markets, the object being to establish the financial framework that is essential to sound development.

Lately, officials at IFC have been glowing over favorable references to the agency in two Reagan speeches—apparently the first time a U.S. President had shown awareness that IFC existed. The mentions were astute and reassuring, because the new Administration development policy is going to need a lot of creative interaction between the public and private sectors, such as IFC represents.

The U.S. and other Western governments can do several things to stimulate private investment and enterprise in the developing world. First and foremost is the conquest of inflation, the biggest drag on growth and development. The uncer-

tainties associated with volatile price movements cause investors to shorten their time horizons and damp their enthusiasm for the long-term commitments that are the meat of economic progress.

Second, the developed nations must keep markets open for the goods Third World countries will be producing as their economies grow bigger and more diverse. Their natural evolution will be into labor-intensive industries such as textiles and shoes, as well as into the processing of their native minerals and other commodities. Threatened industries in the advanced nations clamor for protection. Their demands should be resisted and existing barriers lowered. The long-run benefits from letting comparative advantage work far outweigh the painful adjustments that will have to be made. The U.S., which currently buys about half the Third World's manufactured exports, is in a strong position to exercise leadership on this issue.

Third, government can encourage U.S. corporations to enlarge their direct investment in the Third World—a stake that already comes to \$52 billion. In theory, the relationship between multinational corporations and countries desperately anxious to modernize should be one of mutually beneficial partnership. The corporation gains access to new and growing markets, inexpensive labor, and sources of raw materials. The country, in turn, gets an infusion of technology, exposure to managerial expertise, training that builds up a cadre of skilled workers and experienced managers, and efficient use of its resources, since the corporation is responsive to market discipline.

Ritual polemics

In practice, however, the relationship has been rocky. In their favorite U.N. forums, the countries profess to regard the corporation as part of their problem, not its solution. The polemics ritually include diatribes against the multinationals, which are portrayed as plunderers, exploiters, and even (in the celebrated case of

the infant-food formulas) baby killers.

Such demagoguery is forgotten down where corporation and country deal with each other at the working level. There the relationship is also adversarial, but it has been getting more mature. In the 1960s, new and inexperienced governments were understandably concerned about the power of huge foreign companies whose annual turnover dwarfed their national budgets. And at first, some multinationals were arrogant and patronizing; they *did* throw their weight around.

A new balance of power

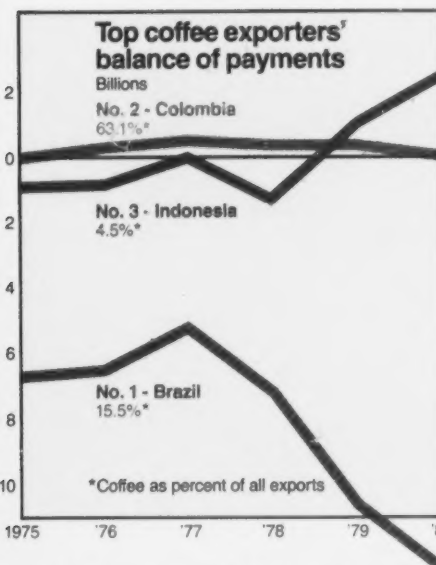
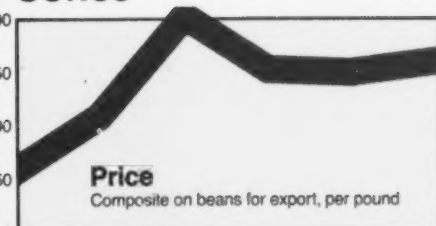
But those host governments have been growing more sophisticated, and their bargaining power has increased. As aggressive German and Japanese multinationals have joined the action, the competition has forced U.S. corporations to become more flexible. They have had to take on contractual obligations to export more of their output, to increase the proportion of a product's content made locally, to share ownership with native investors, even to foster the development of new native industries. These obligations are reasonable enough, but corporations feel the need for a legal framework that can protect them against arbitrary and unreasonable demands.

The search for such a framework led to the establishment, in 1975, of the U.N. Commission on Transnational Corporations, which has undertaken to draft a code of conduct. Being dominated by Third World representatives, however, the commission has often been a forum for verbal abuse of the multinationals and has resisted efforts to write limitations on host-government conduct into the code.

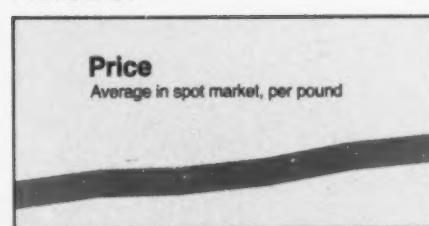
The developing countries are more amenable to reason in bilateral discussion. Several of them have signed investment treaties regulating relations with German and Japanese multinationals. The U.S. has been laggard about getting into this kind of diplomacy, largely because the Carter Administration, reflecting the prejudices of its liberal and union supporters, pro-

continued

Coffee



Rubber



The Commodity Price-Fix Is No Fix

Developing countries frequently contend that gyrations in the prices of the commodities they export throw their international payments out of balance. To correct the problem, they argue for international agreements that would stabilize commodity prices. But the relationship between price movements and international payments balances, as charted above for two commodities and their three major exporters, doesn't support the complaint. Coffee exporters' current-account balances improved when bean prices shot up after the frost of 1975. But even though prices remained fairly high, trouble was brewing for Brazil as fast-rising oil bills siphoned off ex-

port earnings. In contrast, Colombia, though more dependent on coffee than Brazil, experienced little change in its payments balance whether bean prices were high or low.

Rubber prices rose gradually through the late Seventies. But as demand fell with the world industrial slump of the past year, Malaysia and Thailand had more difficulty stretching revenues to cover imports. The slump didn't hurt Indonesia, an OPEC oil producer as well as a coffee and rubber exporter; its current-account balance bounced into surplus with the leap in energy prices.

The figures for the percent of exports that coffee and rubber represent are for 1980.

fessed itself neutral about U.S. investment abroad. Now investment treaties are very much "in."

Harvey Bale, the man at the office of the U.S. trade representative in charge of negotiating the treaties, expects the first, with Egypt, to be completed shortly. Among the late Anwar Sadat's less publicized qualities was his sophistication about foreign investment and his eagerness to welcome it. He actually invited U.S.

companies to compete with government-owned enterprises. The treaty will stipulate that American subsidiaries get legal treatment equal to that given national businesses, assure prompt and adequate compensation in the event of expropriation, prescribe a process for resolving disputes between government and company, and address the sensitive question of a company's right to repatriate capital and earnings.

Another federal agency whose importance has suddenly been enhanced is the Overseas Private Investment Corporation, which insures U.S. investments in Third World countries against political risks that private insurers won't cover. For ten years it operated in obscurity—Craig Nalen, the agency's new president, calls it "Washington's best-kept secret"—largely because Democratic Congresses kept hemming it in with restrictions, for example, on insuring investments in countries whose per capita GNP exceeded \$1,000 (in 1975 dollars).

Now the wraps are coming off. A bill removing most of the legislative inhibitions has just been enacted, and the Administration considers OPIC's expansion vital to its private-sector development strategy. Nalen, whose business career was in marketing, has set in motion "some programs to go out and get business instead of waiting for it to come in over the transom." That means helping to organize investment projects and not merely insuring them. The agency has already been the catalyst for two fairly large-scale U.S. investments in Jamaica, whose business climate improved dramatically with the election of a conservative government last year. One is an integrated poultry operation and the other is a consortium formed by Kaiser Aluminum, Reynolds, and Anaconda to process bauxite.

A high form of sympathy

It is in many small steps like these, not in dramatic breakthroughs, that the Reagan policy will make its impact. The President is not laying out a plan or program with finite goals that can be expressed in numbers. He is proposing a direction to take—the only direction that can lead to progress. In the nature of things, the progress will be slow, simply because the economic development of nations takes a long time. To recognize that is not to be complacent, or unsympathetic to the impatience of the poor. To raise their hopes with grand schemes for redistributing the world's wealth and power is to practice cruel delusion. ■